



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201232036**
Release Date: 8/10/2012

Date: May 15, 2012

Uniform Issue List Numbers:
501.00-00
501.03-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: April 4, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Uniform Issue List: 501.00-00, 501.03-00, 501.03-33, 501.36-01

Legend:

A =
B =
C =
M =
N =
P =
State =
x =
y =
z =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

Facts

You are organized as a non-profit corporation under the laws of State. You were established by A, B, and C (collectively, the "Founders") to provide them with insurance and administrative services. The Founders were established and are controlled by P, a voluntary, non-profit association of local and intermediate x located throughout State.

A is a voluntary employee benefits association, exempt under § 501(c)(9). B is a self-insurance funded pool established pursuant to State statute which allows State y to create self-insurance pools for liability coverage. C, which operates as an employer self-insured fund for workers' compensation insurance, was established pursuant to State statutory authority which allows y to establish a self-insured pool for their workers' compensation obligations. You maintain that the

income of B and C is exempt from federal taxation under § 115.

You are a third party administrator licensed by State. Under State statute, a third party administrator is a person who processes claims pursuant to a service contract and who may also provide one or more administrative services pursuant to a service contract, but a third party administrator does not include a carrier or employer sponsoring a plan.

You have entered into a separate service agreement with each Founder. Your service agreement with A requires you to assume complete responsibility for the administration of A's employee benefit programs, and to provide claims for administration, claim reserve setting, and claims adjudication for A's self-insured employee benefit programs. Your service agreement with B requires you to assume complete responsibility for the underwriting of property and casualty policies, and to provide claims administration, claim reserve setting, and claims adjudication for B's policies. Your service agreement with C requires you to assume complete responsibility for the underwriting of workers' compensation policies. Under each service agreement, you are required to provide sufficient staff to promote each Founder's respective program to prospective new members and adequately serve current members, provide all accounting-related administration, including invoicing of premium, premium collection, payment of claims, financial statement preparation, and to satisfy State Insurance Bureau filing requirements, and assume all expenses related to the administration and promotion of the program, including wages, office supplies, printing, and other administrative expenses. In return for your services, each service agreement provides for you to be paid the service fee set forth in the respective fee and payment schedule. You indicate that you plan to provide third party administrative services to your Founders at cost.

You have entered into an Agent Agreement with M. M is a managing general underwriter that has entered into a Royalty Agreement with P for sponsorship of a liability insurance program for z foundations developed and managed like M (the "Program"). Under your Agent Agreement with M, you undertake to diligently identify z foundation leads for the purpose of marketing the Program to z foundations in State, and you will market the Program for the purpose of obtaining applications for coverage ("Submissions"). You will send all Submissions to M, which will be responsible for underwriting each risk. You will forward quotations to applications as well as written instructions to bind coverage. You will also forward binders and policy numbers to Program policyholders. You will issue invoices to and collect premiums from Program policyholders, which you will remit to M directly. In return for your services, M will pay you ten percent of the written premiums paid by policyholders.

You have also entered into a Producer Agreement with N which gives you the authority to refer submissions to N in return for commissions retained out of premiums collected.

You have a five member board of directors. Two of your directors are also directors of A; one is also a director of B; and one is also a director of C.

Law

Section 501(c)(3) describes organizations including corporations organized and operated exclusively for religious, charitable, scientific or educational purposes, provided no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations (the "Regulations") states that an organization is operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) states that the term "charitable" is used in § 501(c)(3) in its general accepted legal sense. This term includes "lessening the burdens of government."

Rev. Rul. 72-369, 1972-2 C.B. 245, concerns an organization that was formed to provide managerial and consulting services for nonprofit organizations exempt from Federal income tax under § 501(c)(3) to improve the administration of their charitable programs. The organization enters into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The ruling states that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of § 501(c)(3). Furnishing such services at cost lacks the donative element necessary to establish this activity as charitable. Consequently, the ruling holds that the organization's activities are not charitable and therefore the organization does not qualify for exemption under § 501(c)(3).

Rev. Rul. 85-1, 1985-1 C.B. 178, holds that an organization that provides funds to a county's law enforcement agencies to police illegal narcotics traffic lessens the burdens of government and, therefore, qualified for exemption under § 501(c)(3). The criteria for determining whether an organization's activities lessen the burdens of government are: (1) whether the governmental unit considers the organization's activities to be its burdens; and (2) whether these activities actually lessen the burden of the governmental unit. An activity is a burden of the government if there is an objective manifestation by the government that it considers such activity to its burden. The interrelationship between the government and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all the relevant facts and circumstances. In this ruling, the organization provides funding for activities that the local law enforcement agencies treat as an integral part of their program to prevent the trafficking of illegal narcotics, which demonstrates that these activities are part of their burden. With the added funding, the local law enforcement agencies can engage in certain aspects of drug enforcement without the appropriation of additional government funds. Thus, the organization is lessening the burdens of government.

Rev. Rul. 85-2, 1985-1 C.B. 178, holds that an organization that provides legal assistance to guardians ad litem who represent abused and neglected children before a juvenile court that requires their appointment lessens the burdens of government and, therefore, qualifies for exemption under § 501(c)(3). The criteria for determining whether an organization's activities lessen the burdens of government are: (1) whether the governmental unit considers the organization's activities to be its burdens; and (2) whether these activities actually lessen the burden of the governmental unit. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also insufficient to establish that the organization is lessening the burdens of government. The interrelationship between the organization and the government

may provide evidence that the government considers the organization's activities to be its burden. To determine whether the organization is actually lessening the burdens of government, all the relevant facts and circumstances must be considered. A favorable working relationship between the government and the organization is strong evidence that the organization is actually lessening the burdens of the government. In this ruling, the organization's training of lay volunteers is an integral part of the government's program of providing guardians ad litem in juvenile court proceedings. Without the organization's activities, the government could not continue its present program unless it undertook to train lay volunteers itself or appointed attorneys to act as guardians as it had in the past. Thus, the organization actually lessens the burdens of government.

In Columbia Park & Recreation Association, Inc. v. Commissioner, 88 T.C. 1 (1987), aff'd without published opinion, 838 F.2d 465 (4th Cir. 1988) ("Columbia Park"), the petitioner argued that it had a charitable purpose to lessen the burdens of government. According to the petitioner, it provides a wide range of services and facilities to the residents of a large private real estate development and that if it did not provide these services and facilities the local or state government would have to provide them. The Tax Court, in upholding an IRS ruling that the petitioner is not organized and operated exclusively for exempt purposes within the meaning of § 501(c)(3), rejected the petitioner's argument, saying that the mere assertion that, in petitioner's absence, government would have to assume the activities in question does not mean the activities are, in fact, the burdens of government. Rather, the court said, the organization must demonstrate that the government accepts the activities conducted by the petitioner as its responsibility and recognizes petitioner as acting on its behalf. In addition, the organization must further establish that its activities actually lessen the burden of the state or local government. Id. at 21.

B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), concerns a corporation, T, which plans as its sole activity to offer consulting services for a fee to nonprofit, limited resource organizations engaged in various rural-related activities. T's service consists of obtaining appropriate individuals to perform research projects for the clients. Some of T's clients will be exempt organizations, but others may not be exempt. The fees charged by T will be set at or close to cost, but will not be less than T's full cost of providing the services. The Tax Court held that T does not operate exclusively for § 501(c)(3) purposes. The court noted that T's activities are a business of the sort ordinarily carried on by commercial ventures organized for-profit; its source of income is fees for service, not voluntary contributions from the public; and that its clients are not necessarily all § 501(c)(3) organizations. The court said that T had failed to demonstrate that its services are not in competition with commercial businesses. Competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes. The court concluded that since the conduct of a business with an apparently commercial character is T's sole activity, that fact weighs heavily against exemption. Id. at 359.

Analysis

1. Operational Test

To be exempt under § 501(c)(3) you must be operated exclusively for one or more exempt purposes. You will be regarded as operating exclusively for one or more exempt purposes only if you engage primarily in activities that accomplish one or more exempt purposes. § 1.501(c)(3)-1(c)(1).

You provide third party administrative and management services to your Founders by processing insurance claims pursuant to three service contracts. Your activities are indistinguishable from those provided by commercial third party administrators. Your sole source of income is fees for services, not voluntary contributions from the public; your fees are set to cover your costs; and, your clientele is not limited to § 501(c)(3) organizations. Since the conduct of a business with an apparently commercial character is your sole activity, that fact weighs heavily against exemption. See B.S.W. Group, 70 T.C. at 359. Rev. Rul. 72-369, supra, tells us that providing managerial services for a fee is a trade or business ordinarily carried on for profit, and that providing such services, even at cost and solely for exempt organizations, is not a charitable activity within the meaning of § 501(c)(3). Therefore, you do not qualify for exemption from Federal income tax under § 501(c)(3).

2. Lessening the Burdens of Government

You state that you were established for the purpose of relieving the burdens of government. Specifically, you were formed to provide insurance and administrative services for the Founders to relieve those entities of various administrative burdens and reduce the cost of obtaining insurance for State x. But the mere assertion that your activities relieve the administrative burdens of your Founders does not mean that, in fact, those activities are the burdens of government. Rather, you must demonstrate that State accepts your activities as its responsibility and recognizes that you are acting on its behalf. See Columbia Park, 88 T.C. at 21.

The term "charitable" includes lessening the burdens of government. § 1.501(c)(3)-1(d)(2). To qualify as a § 501(c)(3) organization on the basis of lessening the burdens of the government, you must meet a two-pronged test. The first prong requires that a government unit *objectively manifest* that it considers your activities to be its burden. See Rev. Rul. 85-1, and Rev. Rul. 85-2, supra.

You do not meet the first prong of the lessening the burdens of government test as there is no objective manifestation by State that it considers your activities to be its burden. Although you were created pursuant to State's third party administrator statute, the statute merely permits your formation, it does not mandate it, and it does not include a statement that State considers your activities to be its burden. Therefore, we must consider all relevant facts and circumstances in determining whether an objective manifestation exists. "A favorable working relationship between the government and the organization is strong evidence that the organization is actually 'lessening' the burdens of the government." Rev. Rul. 85-2, supra. The stronger the control a government has over the activities of the organization the better evidence of an objective manifestation. Rev. Rul. 85-1, supra. You are not controlled by State. The Founders control your Board; there is no State representation on your Board. As a State licensed third party administrator, you are subject to the same regulatory oversight as insurance agencies under State's insurance code; State has no other role in your operations. Your only source of funding is revenue from the fees you charge Founders for your services. The Founders are paying you for a service. Furthermore, you have not shown that you have a working relationship with State. Therefore, you have not demonstrated an objective manifestation by State recognizing that your activities are its burden or responsibility, as required by Rev. Rul. 85-1 and 85-2, supra.

Even if the first prong of the test was met, you do not meet the second prong of the lessening the burdens of government test. To meet the second prong your activities must actually lessen the burdens of a governmental unit. Evidence that the organization is actually lessening the burdens of government is shown when the government could not continue to conduct its program without the organization's activities. Rev. Rul. 85-2, supra. Here, you have not shown the activities of the Founders are a program of State government. In addition, your activities do not alleviate any fiscal or personnel burden of the State. Rather, you are relieving the administrative burdens of the Founders. There is no evidence you defray any State expenses. Thus, you also fail to meet the second prong of the test and do not qualify under § 501(c)(3) as an organization that is lessening the burdens of the government within the meaning of § 1.501(c)(3)-1(d)(2).

Conclusion

Accordingly, you do not qualify for exemption as an organization described in § 501(c)(3) and you must file federal income tax returns. Contributions to you are not deductible under § 170.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE SE:T:EO:RA:T:1
ATTN: Emily D. Mangrum (NCA-545-01)
1111 Constitution Ave, N.W.
Washington, DC 20224-0002

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations